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Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552

Acting Director

June 21, 1995

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MEMORANDUM FOR: Chief Executive Officers

FROM: Jonathan L. Fiechter
Acting Director

SUBJECT: Regulatory Reporting and Regulatory Capital Treatment of Originated Mortgage Servicing Rights

I am sending you the attached press release issued by the Federal Financial Institutions Examination Council (FFIEC) to provide guidance on the regulatory reporting and regulatory capital treatment of originated mortgage servicing rights (OMSRs). OMSRs generally represent mortgage servicing rights acquired when an institution originates and subsequently sells mortgage loans, but retains the servicing rights.

The FFIEC is issuing the attached guidance in response to the May 1995 decision of the Financial Accounting Standards Board (FASB) to change the accounting treatment of OMSRs under generally accepted accounting principles. The FASB formalized its decisions in Statement of Financial Accounting Standard No. 122, "Accounting for Mortgage Servicing Rights" (SFAS No. 122), which eliminates any difference in the accounting treatment of OMSRs and purchased mortgage servicing rights (PMSRs). The most significant effect of this change is to require institutions to capitalize OMSRs as balance sheet assets. Institutions must adopt SFAS No. 122 for fiscal years beginning after December 15, 1995, but may adopt it as early as June 30, 1995.

Accordingly, the attached FFIEC press release provides guidance on the regulatory reporting treatment of OMSRs, which institutions will only need to follow for their June 1995 Call Reports and Thrift Financial Reports (TFRs) if they elect to adopt SFAS No. 122 early. The June 1995 TFR instructions include reporting instructions for OMSRs for associations electing early adoption.

In addition, the OTS and the other federal banking agencies, consistent with a recommendation of the FFIEC Task Force on Supervision, are developing interim final rules that would subject capitalized OMSRs included in regulatory capital to the 50 percent of Tier 1 (core) capital limit and other constraints currently imposed on PMSRs. The agencies will formally seek public comment on the appropriate permanent regulatory capital

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treatment of [illegible] their interim final rules. The agencies expect to issue their interim final rules in the next month.

If you have any questions about this issue, please contact your OTS regional accountant.

Federal Financial Institutions **Examination Council**

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Press Release

For immediate release **June 21, 1995**

APPLICABILITY OF FAS 122 FOR REPORTING PURPOSES AND THE TREATMENT OF MORTGAGE SERVICING RIGHTS FOR REGULATORY CAPITAL PURPOSES

The Reports Task Force of the Federal Financial Institutions Examination Council (FFIEC), acting under delegated authority, is announcing its decisions regarding the appropriate regulatory reporting treatment for mortgage servicing rights (MSRs) by banks. The Office of Thrift Supervision has reached similar reporting decisions for savings associations. The need for this guidance arises because of the Financial Accounting Standards Board's issuance of Statement No. 122, "Accounting for Mortgage Servicing Rights," in May 1995. In addition, the FFIEC's Task Force on Supervision, acting under delegated authority, is recommending that the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision ("the agencies") adopt interim capital rules to clarify the regulatory capital treatment for MSRs.

MSRs are the contractual obligations undertaken by an institution to provide servicing for mortgage loans owned by others, typically for a fee. "Originated" MSRs (OMSRs) generally represent the MSRs acquired when an institution originates and subsequently sells mortgage loans but retains the servicing rights. "Purchased" MSRs (PMSRs) are MSRs that have been purchased from other parties. Prior to the adoption of Statement No. 122, only PMSRs -- but not OMSRs -- could be capitalized as balance sheet assets. However, once an institution adopts Statement No. 122, it generally must capitalize OMSRs on a prospective basis. In addition, Statement No. 122 requires all capitalized MSRs (both originated and purchased) to be evaluated for impairment based on their fair values.

The Financial Accounting Standards Board has also determined that it is not necessary to characterize MSRs as either tangible or intangible assets when similar characterizations have not been made for most other assets. Statement No. 122 indicates, however, that the elimination of the previous reference in the accounting literature to MSRs as intangible assets does not imply that MSRs are tangible assets.

In view of the issues raised by the issuance of Statement No. 122, the two FFIEC Task Forces are taking the following actions concerning the regulatory reporting and capital treatment of MSRs.

Applicability of Statement No. 122 for Regulatory Reporting Purposes. For purposes of the bank Reports of Condition and Income (Call Report) and Thrift Financial Report (TFR), all insured banks and savings associations must adopt Statement No. 122 for fiscal years beginning after December 15, 1995. Early adoption is also permitted to the extent allowable under Statement No. 122. Thus, for institutions with a calendar year fiscal year that do not elect early adoption, the March 31, 1996, Call Report or TFR will be the first report to be completed in accordance with Statement No. 122. In addition, once an institution adopts Statement No. 122, the fair value of MSRs must be used in determining whether impairment exists, rather than the impairment guidance currently set forth in the Call Report and TFR instructions.[1]

Reporting Treatment for PMSRs and OMSRs. As an interim measure, banks should continue to report PMSRs in Call Report Schedule RC-M, item 6.a, "Mortgage servicing rights," and on the balance sheet in Schedule RC, item 10, "Intangible Assets." OMSRs that are capitalized as balance sheet assets in accordance with Statement No. 122 should be reported in these same Call Report items. Similarly, savings associations should report capitalized MSRs (both purchased and originated) on TFR Schedule SC, line 640, which is currently labeled "purchased loan servicing rights."

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[1] The fair value approach to impairment in Statement No. 122 assumes that a market discount rate is used to calculate the present value of estimated future cash flows. This differs from the existing Call Report and TFR instructions, which require the use of the original discount rate inherent in the servicing rights when measuring impairment.

Interim Capital Treatment for MSRs. Given the provisions in Statement No. 122 that require capitalization of OMSRs as balance sheet assets and the FASB's decision not to characterize MSRs as tangible or intangible assets, the FFIEC's Task Force on Supervision is recommending that the agencies seek public comment on the appropriate regulatory capital treatment of MSRs. Pending completion of this review, the Task Force recommends that the agencies issue interim capital rules that would apply the same regulatory capital provisions to OMSRs that presently apply to PMSRs.

Under the Task Force's recommended interim approach, capitalized MSRs (both purchased and originated) would be subject to a quarterly valuation requirement and a restriction limiting the amount of MSRs that may be recognized for Tier 1 capital purposes to the lesser of 90 percent of fair value or 100 percent of book value (net of any valuation allowance). In addition, the aggregate amount of PMSRs, OMSRs,[2] and purchased credit card relationship intangibles that may be recognized for regulatory capital purposes (i.e., not deducted from assets and capital) would be limited to no more than 50 percent of Tier 1 (core) capital. The quarterly valuations of the fair value of OMSRs would be based on the same regulatory guidance the agencies have issued with respect to determining the fair value of PMSRs.

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[2] For purposes of determining the amount of any OMSRs that would be deducted (or disallowed) under this 50 percent of Tier 1 (core) capital limitation, institutions may choose to reduce the otherwise disallowed OMSRs by the amount of any associated deferred tax liability.

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Jonathan L. Fiechter
Acting Director

July 28, 1995

MEMORANDUM FOR: Chief Executive Officers

FROM: Jonathan L. Fiechter
Acting Director

SUBJECT: BIF/SAIF Senate Banking Committee Testimony

At today's hearing of the Senate Banking Committee, the Treasury, FDIC and the OTS presented our joint proposal for resolving the SAIF and FICO funding problems. Because of the importance of this issue, I am enclosing a copy of my testimony.

This proposal is the culmination of many months of deliberation by the principals and staff of the Treasury, FDIC and OTS. Over that time, we have sought input and an exchange of ideas through an FDIC public hearing on the potential BIF/SAIF premium disparity, contact with key members and staffs of the House and Senate Banking Committees, direct discussions with a number of thrift and bank executives and leaders of the thrift and banking industry trade associations, and a variety of other sources.

I believe our proposal offers a fair and balanced solution to a very difficult problem. Given the nature of the problem and the environment in which we are operating, a painless solution was not possible. There are several components to the solution. The joint proposal places the greatest onus on institutions holding SAIF-insured deposits, which would be required to pay a special one-time premium to capitalize the SAIF by January 1, 1996.

The FICO obligation, presently borne solely by SAIF-member savings associations, would, going forward, be shared by all FDIC-insured institutions. Implementation of these two provisions would remove the threat of the impending premium disparity between the BIF and the SAIF.

Finally, the proposal calls for a merger of the SAIF and the BIF 24 months after the SAIF is fully capitalized. To protect and stabilize the SAIF during the period prior to the fund merger, OTS and the FDIC have supported making leftover RTC funds available to cover extraordinary and unanticipated losses of the SAIF.

It is important for Congress to act this year to correct the problem. We have learned from the thrift crisis that failure to promptly correct an insurance fund problem only makes matters worse. I believe it is important for us to resolve this last vestige of the thrift crisis and put that era finally and completely behind us.

Enclosure